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No. 89-1349

In the Supreme Court of the United States

OCTOBER TERM, 1989

110-118 RIVERSIDE TENANTS CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the government's tax liens on the taxpayer's shares in a cooperative apartment building corporation are superior to the corporation's later claims against the taxpayer for unpaid maintenance fees.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A31) is reported at 886 F.2d 514. The memorandum and order of the district court (Pet. App. A34-A58) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on September 28, 1989. A petition for rehearing was denied on November 21, 1989 (Pet. App. A32-A33). The petition for a writ of certiorari was filed on February 16, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1968, John Broady acquired a proprietary lease of a cooperative apartment at 110 Riverside Drive, New York, by purchasing 417 shares of stock of petitioner, a cooperative apartment corporation. Under the terms of the lease, the shares of stock of petitioner were allocated to the lease. The shares could not be sold separately from the lease, and the lease could not be assigned without assignment of the shares; any sale and assignment required petitioner's approval. The lease also provided that, in the event the owner failed to pay his monthly proportionate share of maintenance expenses and after appropriate notice, the lease would terminate and the shares would be surrendered to petitioner. Petitioner would then sell the shares, and, after the sale's proceeds were applied to the indebtedness, the surplus would be paid over to the former owner. Pet. App. A3-A6.

In 1975, the Internal Revenue Service properly filed notices of tax liens against Broady for assessed but unpaid income tax liabilities for the years 1951-1954. Petitioner received notice of these tax liens in 1975. In 1979, the government commenced an action in the United States District Court for the Southern District of New York against Broady and petitioner, seeking a judgment against Broady for the unpaid assessed taxes and to foreclose the tax liens on Broady's shares of stock in petitioner. Pet. App. A3-A6, A34-A35.

On March 22, 1984, the district court granted the government's motion for summary judgment against Broady, and on July 10, 1984, judgment was entered against him in the amount of $2,396,264.12, which reflected his outstanding tax liability, plus accrued interest and penalties. On March 11, 1985, the clerk entered a final judgment ordering foreclosure of the lien against Broady's

shares of petitioner's stock. No appeal was taken from this judgment. Shortly thereafter, in April 1985, Broady stopped paying his monthly maintenance fee to petitioner. Pet. App. A6, A35.

Petitioner subsequently undertook efforts to evict Broady, which was accomplished in July 1986. In September 1987, petitioner entered into a contract for the private sale of the cooperative apartment, *i.e.*, for the shares formerly owned by Broady, which would be accompanied by a proprietary lease. Petitioner moved the district court for an order approving the sale of the cooperative apartment, and for transmittal to the government of the net sale proceeds *after* payment of the monthly maintenance arrearages owed to petitioner by Broady and of petitioner's costs incurred in the eviction and sale. The government in turn made its own motion to approve the private sale of the apartment, maintaining its entitlement to the proceeds without prior deduction of Broady's debts to petitioner. In January 1988, while the motions were pending, the court approved a stipulation of the parties providing for the sale of Broady's shares of petitioner's stock, and the shares subsequently were sold for $901,030. Pet. App. A7-A8, A36.

Pursuant to the stipulation, $90,130 of the sale proceeds was placed in escrow by petitioner's counsel, Snow Becker Krauss P.C. (Snow Becker), pending the outcome of a government motion to compel Snow Becker to turn over the funds to the government as a priority lienholder of Broady. This amount reflected petitioner's claim for unpaid maintenance charges, legal fees and other miscellaneous charges accruing between March 1985 and April 1988. The remainder of the sale proceeds was paid over to the government. Pet. App. A37-A38.

3. The district court granted the government's motion to require the funds held in escrow by Snow Becker to be

paid over to the United States (Pet. App. A34-A55). The district court found that the government's interest in Broady's property was superior to that of petitioner because the government's tax liens were filed in 1975, long before Broady even owed a debt to petitioner (*id.* at A52-A53). And the court rejected petitioner's contention that Broady's "property interest" in his shares was limited by the terms of the lease to the net proceeds (after deduction of amounts owed to petitioner) of any sale. The court stated that, under New York law, an "interest in a cooperative apartment is *sui generis* . . .; the interest is represented by shares of stock, which are personal property, yet in reality what is owned is not an interest in an ongoing business enterprise, but instead a right to possess real property" (*id.* at A48). The court concluded that nothing in New York law suggests that the terms of the lease are "incident[s] of ownership" of the property (*id.* at A48-A49). Accordingly, the court concluded, petitioner merely had a "consensual security interest" (*id.* at A52-A53) in Broady's shares in the cooperative, which was "inchoate" when the tax liens attached in 1975 (ten years before Broady stopped paying his maintenance fees). Therefore, the government's tax liens clearly had priority over petitioner's security interest.

4. The court of appeals affirmed with modifications (Pet. App. A1-A31).[1] The court of appeals agreed with the district court that there was no doubt that the federal tax liens had priority over any security interest claimed by petitioner (*id.* at A13-A16). The court also rejected petitioner's contention that, as a matter of state law, Broady's

[1] The court of appeals modified the district court's judgment by directing that the costs incurred by petitioner in evicting Broady and in privately selling the shares, with the government's approval, should be deducted from the sale proceeds before turning the proceeds over to the government (Pet. App. A22-A30).

property interest in his shares was limited to any surplus over debts owed to petitioner (*id.* at A16-A22). The court noted that, at the time the federal tax liens attached, Broady did not owe any money to petitioner, and therefore his "property interest was to all the proceeds of the shares" (*id.* at A22). The court of appeals also rejected petitioner's reliance on *Chicago Mercantile Exchange* v. *United States*, 840 F.2d 1352 (7th Cir. 1988), which involved a taxpayer's property interest in his seat on the Exchange, finding that the two situations are distinguishable (Pet. App. A18-A21).

ARGUMENT

The court of appeals correctly held that the federal tax liens here had priority over petitioner's claim for unpaid maintenance fees, and therefore that the proceeds of the sale of the shares of cooperative stock must be applied to Broady's tax debts without prior reduction for Broady's debts to petitioner. This decision is fully consistent with the decisions of this Court, and does not conflict with any decision of another court of appeals. Accordingly, there is no reason for review by this Court.

1. Section 6321 of the Internal Revenue Code (26 U.S.C.) provides that, if any person liable to pay any tax neglects or refuses to pay the tax after notice and demand, the amount of the tax, plus interest and statutory additions, shall be a lien upon "all property and rights to property, whether real or personal, belonging to such a person." Section 6322 specifies that the lien arises at the time the taxes are assessed and continues until the liability is satisfied or becomes unenforceable by reason of lapse of time. As this Court has noted, the phrase "all property and rights to property" in Section 6321 is "broad and reveals on its face that Congress meant to reach every interest in

property that a taxpayer might have." *United States* v. *National Bank of Commerce*, 472 U.S. 713, 719-720 (1985). The Court has also explained that these provisions do not themselves create any property rights; rather, the threshold question whether a taxpayer possesses "property" or "rights to property" to which the tax lien can attach is determined by state law. *Aquilino* v. *United States*, 363 U.S. 509, 512-513 (1960); *United States* v. *Bess*, 357 U.S. 51, 55 (1958).

The courts below did not depart from this established scheme. Both courts looked to New York law to determine the extent of Broady's interest in the shares of petitioner's stock (see Pet. App. A17, A48-A49), and the courts held that his property interest in those shares, to which the tax liens attached, was not limited to the surplus over the debts owed to petitioner. Petitioner does not question that the federal tax liens were superior to any security interest held by petitioner, and therefore petitioner's only basis for objection is that the courts below incorrectly interpreted state law. Even if it had merit, that objection would not provide an adequate reason for review by this Court; a case that is "governed by * * * state law" (Amicus Br. 26) does not meet the criteria for the exercise of this Court's certiorari jurisdiction. See Sup. Ct. R. 10.1.

There is in any event no merit to petitioner's argument that the courts below erroneously interpreted New York law. The only case cited by petitioner in this connection (Pet. 21), *Banks* v. *Cox, Treanor & Shaughnessy*, 81 A.D. 2d 504, 437 N.Y.S.2d 331 (1981), lends no support to its argument. There, the intermediate New York appellate court, in a brief opinion, held that the New York "Lien Law" could not be invoked to defeat a cooperative association's effort to collect certain delinquencies that a former owner had agreed to pay; the court characterized the association's demand as a "claim," rather than a "lien."

This decision in no way suggests that the owner of shares in a cooperative does not have a property interest in all of the proceeds of the sale of those shares; indeed, whether petitioner's rights against Broady here are characterized as a "claim" or as a "lien," it is clear that they cannot defeat the prior federal tax lien. Moreover, even if there were some basis for arguing that the courts below had misconstrued state law, this Court has repeatedly noted that "[i]n dealing with issues of state law that enter into judgments of federal courts, we are hesitant to overrule decisions by federal courts skilled in the law of particular states unless their conclusions are shown to be unreasonable." *United States* v. *Durham Lumber Co.*, 363 U.S. 522, 526-527 (1960); *Propper* v. *Clark*, 337 U.S. 472, 486-487 (1949). Thus, there is no reason to grant certiorari here.[2]

2. Contrary to petitioner's contention (Pet. 25-30), there is no conflict between the decision below and the decision of the Seventh Circuit in *Chicago Mercantile Ex-*

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[2] There is no merit to petitioner's contention that the decision below conflicts with this Court's decision in *United States* v. *Durham Lumber Co.*, *supra*. In that case, this Court agreed with the court of appeals' finding that, under North Carolina law, subcontractors who have not been paid by the general contractor have more than a lien on the general contractor's claim against the owner, they have a direct, independent cause of action against the owner. 363 U.S. at 524-525. This means that "any money owed by the owner under the construction contract must first be used to satisfy subcontractors' claims of which the owner has notice" (*id.* at 525). Accordingly, the Court held, "under North Carolina law, the general contractor did not have a property interest in the face amount, as such, of the general construction contract," but merely possessed a right to the residue of the fund (*ibid.*). Thus, while the taxpayer in *Durham* had a more limited property interest in the property subject to the federal tax lien than did Broady in this case, that difference is entirely attributable to the different state law rules governing each situation. The decision of the court of appeals below thus is fully consistent with this Court's decision in *Durham*.

change v. *United States*, 840 F.2d 1352 (1988). In *Chicago Mercantile*, the taxpayer owned a seat on the Chicago Mercantile Exchange; he owed amounts to other members for claims related to his business on the Exchange and he also owed federal tax liabilities. The Exchange claimed that, pursuant to its internal rules, the Exchange-related claims were to be paid first out of the proceeds of the sale of the taxpayer's seat, with the federal tax liabilities to be paid only out of the remainder. The Seventh Circuit agreed, finding "control[ling]" this Court's decisions in *Hyde* v. *Woods*, 94 U.S. 523, 525 (1877), and *Board of Trade* v. *Johnson*, 264 U.S. 1, 12 (1924), to the effect that "the holder of an exchange seat holds that seat subject to the exchange rules, which define and limit his property interest" (840 F.2d at 1356). The court of appeals emphasized that its holding was "very narrow" and "only reiterate[d] the Supreme Court's holding that property rights in an exchange membership are determined by the exchange rules" (*id.* at 1358).

Thus, the decision below is consistent with *Chicago Mercantile*. The Seventh Circuit, following precedent of this Court governing the definition of property interests in seats on an exchange, held that, under the rules of the Chicago Mercantile Exchange, the only property interest ever acquired by the member was the interest remaining after Exchange-related claims were satisfied. The Seventh Circuit was careful to limit the scope of its holding to the context of seats on an exchange, where "exchange priority rules are incidents of the membership interest at its inception" (840 F.2d at 1358). The court below correctly distinguished *Chicago Mercantile* on the ground that "shares of stock in a cooperative corporation are not the same as membership in an exchange" (Pet. App. A21).[3] As

[3] Indeed, the court in *Chicago Mercantile* itself specifically stated that if a condominium association drafted a rule that "no member

the court below explained (*ibid.*), "[h]ere the shareholder is entitled to the full value and property interest of the shares subject only to default and can transfer the same subject to the consent requirement of the Lease." Since Broady was not in default when the federal tax lien attached, and therefore there was no indebtedness due to petitioner at that time, the court of appeals correctly concluded that Broady's property interest "was to all the proceeds of the shares" (*id.* at A22).[4]

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could sell his or her unit without paying off debts to other members," that situation would be distinguishable from the case of a seat on an exchange. The court explained: "such a rule would *not* have priority over a tax lien on the condominium unit, since the rule is *not* an attribute of the unit under state law * * * [but] is merely a consensual security interest created later." 840 F.2d at 1358 n.7.

[4] The other cases cited by petitioner as conflicting with the decision below (Pet. 30-32) are clearly inapposite. *Johnson* v. *United States*, 799 F.2d 374 (8th Cir. 1986), *Brookbank, Inc.* v. *Hubbard*, 712 F.2d 399 (9th Cir. 1983), and *Runkel* v. *United States*, 527 F.2d 914 (9th Cir. 1975), all involved a question quite different from the one presented here. The courts there held that a seller of real property under a contract for deed was not required by the provisions of 26 U.S.C. 7425(b) (1982) to give notice to the United States upon exercising his right of forfeiture under state law, where federal tax liens had been filed against the purchaser's property. The courts concluded that the statute required notice to be given only in the case of a "sale of property," and a forfeiture was not a "sale" under this provision. (These cases were effectively overruled by Congress in Section 1572 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2765, which added a new Section 7425(c)(4) to provide that, "[f]or purposes of subsection (b), a sale of property includes the forfeiture of a land sales contract." See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. at II-818 (1986).) In *Pittsburgh National Bank* v. *United States*, 657 F.2d 36 (3d Cir. 1981), the court held that a unique provision of Pennsylvania law, which afforded a bank an automatic right of setoff against a debtor's interest in a checking account, upon the maturity of the debtor's note in favor of the bank, had the effect of defeating a

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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federal tax lien against the debtor, where the debt matured before the government served its notice of levy.

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